



Licensing for Investment Advisers

TOPICS COVERED:

What is an Investment Adviser?
Federal vs. State Regulation
The Adviser and its Reps
Licensing Fees
Compliance Responsibilities
Licensing Process
Filing Form ADV
Annual Requirements
Withdrawals and Terminations

WHAT IS AN INVESTMENT ADVISER?

An Investment Adviser is simply someone who provides advice on securities for compensation. However, Investment Advisers can render that advice in numerous ways, including:

- Issuing reports or analysis on securities
- Making recommendations to buy or sell securities
- Managing a client's securities portfolio
- Preparing financial plans that involve securities recommendations
- Managing an investment fund that allows for the investment in securities

To determine whether a particular business would be required to license as an Investment Adviser, please view the Division's website at securities.utah.gov or contact the Division at (801) 530-6600.

FEDERAL vs. STATE REGULATION

Since 1996, the regulation of Investment Advisers has been divided between the U.S. Securities and Exchange Commission (SEC) and the states. With the passage of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* in 2010, the dividing line between state-regulated and federally-regulated advisers will shift so that more advisers are regulated by the states.

Currently, Utah regulates those Investment Advisers with less than \$25 million in assets under management and are either located in Utah or have more than five clients in Utah (note: Utah's definition of "client" differs from the SEC definition and requirements may vary by state).

Currently, the SEC regulates Investment Advisers with more than \$25 million in assets under management. However, federal-covered advisers must still notice-file in Utah if they are either located in the state or have more than five clients in Utah (note: requirements may vary by state). Also, federal-covered advisers must still license any IA Rep with a place of business in Utah or more than five clients in Utah.

In July 2011, the asset level that determines whether an Investment Adviser is regulated by the states or the SEC will change from \$25 million to \$100 million. This process is known as the "IA Switch" since a number of middle-sized advisers (with assets between \$25 million and \$100 million) will need to switch from federal to state regulation.

THE ADVISER AND ITS REPS

Throughout the licensing process, remember the difference between the advisory firm and individuals who work for that firm. The *firm* is the entity that licenses as an Investment Adviser. *Individuals* license as Investment Adviser Representatives (IA Reps).

This distinction helps to understand the different forms that need to be filed to license both the Investment Adviser and any of its IA Reps (the Investment Adviser files a Form ADV for itself and a Form U-4 for each IA Rep). Also, this distinction is helpful when filing the Form ADV because some questions ask about "you" with the intention that those questions reference the Investment Adviser itself, not its IA Reps.

Only when a firm is organized as a sole-proprietorship would a person be licensed as both an Investment Adviser and an IA Rep (note: most firms are organized as corporations or as limited liability companies).

LICENSING FEES

All fees are paid through the Investment Adviser Registration Depository (IARD) system and processed by FINRA. Do NOT send any payments to the Division.

Investment Adviser License (new and renewal)	\$100.00
Investment Adviser Representative License (new and renewal)	\$50.00
Federal-Covered Adviser Notice Filing Fee (new and renewal)	\$100.00

COMPLIANCE RESPONSIBILITIES

The Division sees many different business backgrounds in those who seek to create their own investment advisory firm. Some start their own Investment Adviser after working for another Investment Adviser or a broker-dealer. Others come from non-securities industries, such as real estate or insurance. Some have no professional experience at all. Regardless of the applicant's experience or business background, the compliance responsibilities are the same.

The securities industry is highly regulated as it can involve the life savings of investors. Consequently, the Investment Adviser license comes with many compliance responsibilities that may be new and intimidating to those who have not encountered them before. Indeed, obtaining a license is a small task compared to the ongoing compliance responsibilities of managing your own advisory firm.

In addition to the Utah Uniform Securities Act and Rules, Utah also incorporates federal requirements from the Investment Advisers Act of 1940. Investment Advisers must also keep up to date on any changes to these laws and regulations that may arise.

Some of these compliance responsibilities include, but are not limited to: annual amendments to the Form ADV, maintaining books and records, maintaining minimum financial requirements, bonding requirements, approving advertisements and seminars, and the supervision of IA Reps (note: specific requirements will depend on the specific nature of the investment advisory business and may vary by state).

LEGAL DEFINITION

§61-1-13(1) of the Utah Uniform Securities Act defines an Investment Adviser as follows:

- (q)(i) "Investment adviser" means a person who:
- (A) for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities; or
 - (B) for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning securities.
- (ii) "Investment adviser" includes a financial planner or other person who:
- (A) as an integral component of other financially related services, provides, provides the investment advisory services described in Subsection (1)(q)(i) to others for compensation and as part of a business; or
 - (B) holds the person out as providing the investment advisory services described in Subsection (1)(q)(i) to others for compensation.
- (iii) "Investment adviser" does not include:
- (A) an investment adviser representative;
 - (B) a depository institution or trust company;
 - (C) a lawyer, accountant, engineer, or teacher whose performance of these services is solely incidental to the practice of the profession;
 - (D) a broker-dealer or its agent whose performance of these services is solely incidental to the conduct of its business as a broker-dealer and who receives no special compensation for the services;
 - (E) a publisher of a bona fide newspaper, news column, news letter, news magazine, or business or financial publication or service, of general, regular, and paid circulation, whether communicated in hard copy form, or by electronic means, or otherwise, that does not consist of the rendering of advice on the basis of the specific investment situation of each client;
 - (F) a person who is a federal covered adviser;
 - (G) a person described in Subsection (3); or
 - (H) such other persons not within the intent of this Subsection (1)(q). as the division may by rule or order designate.

IMPORTANT SECURITIES LAWS TO KEEP YOUR INVESTMENT ADVISER COMPLIANT IN UTAH

Utah Uniform Securities Act: §61-1-2 Unlawful Acts for Investment Advisers; §61-1-3 Licensing; §61-1-4 Licensing Procedures; §61-1-5 Post-Licensing Provisions; §61-1-13 Definitions; §61-1-16 False Statement Unlawful.

Utah Administrative Code (Current Rules): R164-2-1 Performance-Based Compensation; R164-2-2 Custody; R164-4-3 Licensing; R164-4-4 Minimum Financial Requirements and Reporting; R164-4-5 Bonding Requirements; R164-4-6 Notice Filing; R164-4-7 Internet; R164-4-9 Exemptions; R164-5-1 Record-Keeping; R164-5-3 Financial Reporting; R164-6-1g Dishonest or Unethical Business Practices.

Investment Advisers Act of 1940: Sec. 204A Privacy; Sec. 205 Contracts; Sec. 206 Prohibited Transactions; Sec. 215 Hedge Clauses.

SEC Rules (Rules to the 1940 Act): Rule 206(4)-2 Custody Rules; Rule 204-2 Books and Records; Rule 206(4)-1 Advertising.

LICENSING PROCESS

To license as an Investment Adviser in Utah, the Investment Adviser and its designated official must complete the following process.

1. **FORMATION.** Form and register the entity that will become the Investment Adviser. If organizing in Utah, contact the Utah Division of Corporations to register the business. You may also need to register with your local municipality as well. If organizing outside of Utah or licensing in multiple states, please contact the state's securities regulator in each state you will conduct business.
2. **IARD ENTITLEMENT.** The Investment Adviser will apply, file forms, and make payments online through the Investment Adviser Registration Depository (IARD), an online database run by FINRA. The Investment Adviser will be assigned a six-digit IARD/CRD number. Once entitled to the IARD, the firm will also have access to the Central Registration Depository (CRD) where it will file Form U-4's for its IA Reps (note: all IA Reps are assigned a separate CRD number that stays with the individual throughout their career in the securities industry). To begin the entitlement process, visit **www.iard.com** or call the IARD Call Center at (240) 386-4848.
3. **FORM ADV.** Once entitled to use the IARD system, the Investment Adviser must file Form ADV through the IARD system. In filing the Form ADV, the Investment Adviser specifies whether it is registering with the SEC or licensing with the state(s). The Form ADV also requires the Investment Adviser to provide detailed information about the proposed advisory business to both regulators and advisory clients. For these two audiences, the Form ADV has two parts: Part 1 and Part 2. More information about Part 1 and Part 2 follows in the "**Form ADV**" section of this brochure.
4. **DESIGNATED OFFICIAL (and other IA Reps).** Every Investment Adviser must have a designated official. The designated official is a person that is a partner, officer, director, sole proprietor, or a person occupying a similar status or performing similar functions in an investment advisory firm. The designated official must also be licensed as an Investment Adviser Representative (IA Rep) of the Investment Adviser. While the Division will license an Investment Adviser with only one IA Rep (i.e. the designated official), the Investment Adviser is responsible for ensuring that all those employed or compensated by the Investment Adviser are properly licensed as an IA Rep (if necessary). See the "**Licensing IA Reps**" section of this brochure for specific licensing requirements.

For more on licensing IA Reps, contact the Division or view the *Investment Adviser Representatives* page on the Division's website: **www.securities.utah.gov/industry/license_iarep.html**

LEGAL DEFINITION

§61-1-13(1) of the Utah Uniform Securities Act defines an Investment Adviser Representative as follows:

(r)(i) "Investment adviser representative" means a partner, officer, director of, or a person occupying a similar status or performing similar functions, or other individual, except clerical or ministerial personnel, who:

- (A) (I) is employed by or associated with an investment adviser who is licensed or required to be licensed under this chapter; or
(II) has a place of business located in this state and is employed by or associated with a federal covered adviser; and
- (B) does any of the following:
 - (I) makes a recommendation or otherwise renders advice regarding securities;
 - (II) manages accounts or portfolios of clients;
 - (III) determines which recommendation or advice regarding securities should be given;
 - (IV) solicits, offers, or negotiates for the sale of or sells investment advisory services; or
 - (V) supervises employees who perform any of the acts described in this Subsection (1)(r)(i)(B).

(ii) "Investment adviser representative" does not include a person described in Subsection (3).

Licensing IA Reps

To license the designated official (and other individuals) as an IA Rep, the Investment Adviser must file Form U-4 through the CRD system (same online database as the IARD system) and the IA Rep must meet the exam requirements.

Form U-4

The Form U-4 reports personal information about the individual, such as: employment history and disciplinary records.

Exam Requirements

To be approved as an IA Rep, the individual must have either:

- (a) a valid Series 65 exam; or
- (b) both a valid Series 7 and a valid Series 66 exam.

LICENSING PROCESS *(Continued from page 3)*

5. **NOTIFICATION TO THE DIVISION.** While the Form ADV is filed electronically through the IARD system, the Investment Adviser must also submit a written notification to the Division that:

- (a) identifies the designated official for the Investment Adviser;
- (b) indicates whether the Investment Adviser will have either custody of or discretionary authority over client funds or securities; and
- (c) demonstrates that the adviser has met the bonding requirements or minimum net worth requirements, both of which are \$35,000 for custody and \$10,000 for discretionary authority.

For those that bond, you may submit Form 4-5BIA (one version for custody another for discretionary authority) or a form with similar information. For those that seek to meet the minimum net worth requirement, the Division typically requires an independently-audited balance sheet showing the net worth or similar proof. For any Investment Adviser that is also registered as a broker-dealer firm, proof of membership in SIPC may be accepted in lieu of the bonding or minimum net worth requirements.

6. **REVIEW PROCESS.** The Division reviews the Form ADV, any additional documentation submitted, and other information about the Investment Adviser, its management, and IA Reps in order to identify any regulatory concerns at the outset. The goal of this review process is so Investment Advisers can start their business on a compliant path. If the Division identifies any deficiencies or has further questions, it will send a Comment Letter and will require that all concerns be resolved before approving the license. This process may take thirty days or longer to complete, however.

7. **APPROVAL.** The Division will notify the Investment Adviser once its license is approved, but will not send any official notification or certificate. The Investment Adviser can always view their licensing status through the IARD system and the public can verify the Investment Adviser is licensed through the SEC's Investment Adviser Public Disclosure website at: **www.adviserinfo.sec.gov**

To remain approved, the Investment Adviser should also review the "**Annual Requirements**" section of this brochure for more information.

If you have any additional questions about the licensing process for Investment Advisers or IA Reps, please contact the Division.

FUND MANAGEMENT INFO

If an Investment Adviser will serve as the manager for any type of pooled investment vehicle (e.g. hedge funds), the Division may require additional information about the advisory business and the investment fund before licensing the Investment Adviser.

For any Investment Adviser that will manage an investment fund, the Division requires the following to begin its review process:

- (a) an explanation of how the securities offering will be made to investors (see §61-1-7 of the Utah Uniform Securities Act);
- (b) a copy of the private placement memorandum (or any other disclosure document);
- (c) a copy of the subscription agreement; and
- (d) detailed information about any investors currently invested in the fund (if any).

OTHER DOCUMENTS

The Division's website has a Securities Library where industry can view various securities laws and regulations. Investment Advisers may consider reviewing the following documents:

DIVISION WHITE PAPERS

- Varying/Negotiating Hourly Fees
- Retainer Fees for Advisers
- Advisory Fees Based on Net Worth

NO-ACTION LETTER

- *Education CRA Management and Education CRA Fund, LLC (2007)*

INTERPRETIVE OPINION

- *Foresee Strategies Fund, L.P. and Foresee Management, LLC (2004)*

FILING FORM ADV

Form ADV Part 1

Form ADV Part 1 is an online form accessed through the IARD system and can be easily updated at any time. For that reason, it is best for answers to reflect the firm as it currently exists, unless specifically instructed otherwise. Essentially, consider Form ADV Part 1 as a snapshot of the Investment Adviser today.

Form ADV Part 2 (new)

Form ADV Part 2 now consists of (at least) two, separate and self-created documents: a *FIRM BROCHURE* and a *BROCHURE SUPPLEMENT*. While only regulators see Form ADV Part 1 (some portions are publicly viewable), the Form ADV Part 2 is a public disclosure document that must be provided to all advisory clients.

The *FIRM BROCHURE* provides clients with detailed information about the Investment Adviser, including: its owners and management, its services and fees, any other or affiliated businesses, disciplinary information, any conflicts of interest, brokerage practices, etc. Depending on the nature of the advisory business, a firm may have multiple versions of its *FIRM BROCHURE*.

The *BROCHURE SUPPLEMENT* provides clients with detailed information about owners, management, and/or individual IA Reps of the Investment Adviser, such as: education and business background, disciplinary information, outside business, any conflicts of interest, etc. Depending on the organization of the Investment Adviser, the firm may have multiple *BROCHURE SUPPLEMENTS* for specific groups of advisory clients.

All Part 2 documents are to be written in plain-English narratives and follow detailed instructions as to their content (see Form ADV Part 2 Instructions). Also, all Part 2 documents need to be text-searchable PDF files and uploaded to the IARD system. Investment Advisers may also need to create an additional Part 2 document if they offer a wrap fee program.

MORE INFORMATION ON FORM ADV

Forms Online

While the Form ADV Part 1 needs to be filed through the IARD system, a paper copy of Part 1 (along with a glossary) and the instructions for drafting Part 2 are available on the Division's website.

November 1 Investment Adviser Workshop

The Division invited Investment Advisers to a workshop to discuss the new Form ADV Part 2. The workshop covered the content and organization of the Part 2 documents, guidance on writing Part 2 in plain-English, creating a PDF version of Part 2 documents, and uploading Part 2 documents onto the IARD. Video rebroadcast of the workshop, including resources used during the workshop, are available at:

securities.utah.gov/industry/Nov2010Workshop.html

Sample Part 2 Documents

Since drafting the Form ADV Part 2 documents may be challenging for new and established Investment Advisers alike, the Division has prepared some sample Part 2 documents for advisers to review. These documents are available to download at:

securities.utah.gov/industry/license_investadviser.html

Please note that these documents are provided as an example and the language used in these documents may not be appropriate for your advisory business.

These documents are designed to provide: an idea on the layout and organization of Part 2; sample plain-English descriptions of complicated financial matters; and examples of how to write for advisory clients while answering specific regulatory questions.

Other Resources

Investment Advisers may also look for guidance on the new Form ADV Part 2 from the SEC at **www.sec.gov** and NASAA at **www.nasaa.org**

Investment Advisers may also consider hiring a compliance consultant or attorney to assist with the drafting of these documents.

ANNUAL REQUIREMENTS

Annual Renewals

All licenses (both Investment Adviser and IA Rep) expire each year on December 31. Toward the end of each calendar year, licensed Investment Advisers receive communication from FINRA regarding the renewal process. Licenses are automatically renewed so long as the Investment Adviser has enough funds in their IARD account to cover the renewal fees for the Investment Adviser and all of its IA Reps (see the “**Licensing Fees**” section for fee amounts).

Annual Amendments and Other Amendments

Investment Advisers must also file an *Annual Amendment* to the Form ADV. This is to ensure that the information in the Form ADV remains accurate. The *Annual Amendment* must be filed each year within 90 days from the end of the Investment Adviser’s fiscal year.

Additionally, the Investment Adviser must make an *Other Than Annual Amendment* promptly after any material changes to the Investment Adviser occurs. Lastly, while the Form U-4 must also be amended promptly after any material changes or events occur for the IA Rep, no separate annual amendment is required for the Form U-4.

WITHDRAWALS AND TERMINATIONS

To withdraw an application or terminate a license, the Investment Adviser must electronically file Form ADV-W through the IARD system.

CONTACT THE DIVISION

The Division is available to answer any licensing questions and assist Investment Advisers through the licensing process.

Hours of Operation: Monday -- Thursday, 7am to 6pm
Main Telephone: (801) 530-6600
Toll-Free in Utah: 1-800-721-7233
E-mail Address: securities@utah.gov



DIVISION AUDITS

Pursuant to §61-1-5 of the Utah Uniform Securities Act, the Division may conduct an examination of any Investment Adviser licensed in Utah. Moreover, failing to comply with a reasonable request from the Division for information or testimony, or an examination request made pursuant to the aforementioned §61-1-5 would be considered a dishonest or unethical business practice under Utah’s R164-6-1g(E)(23).

COMMON DEFICIENCIES

The most common deficiencies seen during the review process are:

Business Description

The Form ADV requires the Investment Adviser to describe their business, including the services rendered and fees charged. Many deficiencies result from insufficient disclosure of the advisory business.

Conflicts of Interest

Failing to disclose conflicts of interest is another common deficiency seen during the review process. R164-6-1g(E)(11) of the Utah Administrative Code (UAC) requires that such disclosures be made.

Unreasonable Advisory Fees

Some Investment Advisers seek to charge advisory fees that exceed industry standards, which the Division considers unreasonable advisory fees and are prohibited by R164-6-1g(E)(10) of the UAC.

Outside or Affiliated Business

All outside or affiliated business of the Investment Adviser or its IA Reps should be disclosed on Form ADV along with any conflicts of interest that business may create.

Inconsistent Information

Form ADV Part 1 and Part 2 ask similar questions and the Division often finds that answers given on Part 1 do not match those given on Part 2.